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Supreme Court of the United States

OCTOBER TERM, 1955

No. 762

CHARLES F. DALLY and SARAFRANCIS DALLY,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

CLIFFORD HOOF,
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THE ARGUS PRESS, SEATTLE

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INDEX

	Page
Petition for Writ of Certiorari	1
Citation to Opinions Below	1
Jurisdiction	1
Question Presented	2
Statutes Involved	2
Statement	3
Reasons for Granting Writ	6
Conclusion	8

TABLE OF AUTHORITIES CITED

Dally v. Commissioner (9 Cir.) 227 F.2d 724	1
Dally v. Commissioner, 20 T.C. 894	1, 5
Lucas v. North Texas Lumber Co., 281 U.S. 11	6, 8
Spring City Foundry Co. v. Commissioner, 292 U.S. 182	6, 8
United States v. Harmon (10 Cir.) 205 F.2d 919	6, 8

STATUTES

28 U.S.C. Section 1254(1)	1
26 U.S.C. Section 41	2
26 U.S.C. Section 42(a)	2
26 U.S.C. Section 1141	6
26 U.S.C. Section 1142	6
26 U.S.C. Section 272	5

APPENDIX A

Judgment and Opinion Below (*Dally v. Commissioner* (9 Cir.) 227 F.2d 724)	9

APPENDIX B

Decision of Tax Court (*Dally v. Commissioner*, 20 T.C. 894)	17

Supreme Court of the United States

OCTOBER TERM, 1955

CHARLES F. DALLY and SARAFRANCIS DALLY, *Petitioners,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. .....

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above entitled case on November 21, 1955, rehearing being denied December 22, 1955.

CITATION TO OPINIONS BELOW

The opinion of the Tax Court of the United States is reported in 20 T.C. 894 (R. 75) and is printed in Appendix B hereto, *infra,* p. 17. The opinion of the United States Court of Appeals for the Ninth Circuit, printed in Appendix A, hereto, *infra,* p. 9, is reported in 227 F.2d 724.

JURISDICTION

The Judgment of the United States Court of Appeals for the Ninth Circuit was entered on November 21, 1955, p. 15, *infra.* Rehearing was denied on December 22, 1955, p. 15, *infra.* The jurisdiction of this court is invoked under 28 U.S.C., Section 1254 (1).

QUESTION PRESENTED

Where, under a Government contract, the submission of a certified voucher was a condition precedent to payment to taxpayer, the voucher and certification in question being prepared by the Government on January 6, 1943, covering a period of work performed from December 16, 1942, to December 31, 1942, and said voucher being certified and submitted by the taxpayer on January 6, 1943, did income accrue to taxpayer in the year 1942 or in 1943.

STATUTES INVOLVED

26. U.S.C. Sec. 41:

"The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect income. If the taxpayer's annual accounting period is other than a fiscal year as defined in Section 48 or if the taxpayer has no annual accounting period or does not keep books, the income shall be computed on the basis of the calendar year."

26 U.S.C. Sec. 42(a):

"GENERAL RULE. The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under Section 41, any such amounts are to

be properly accounted for as of a different period. * * * "

STATEMENT

The petitioners, Charles F. Dally and Sarafrancis Dally, are husband and wife, and all income involved was community income. Their income tax returns were filed for the years 1942 and 1943 with the Collector of Internal Revenue for the District of Washington, and the petitioners were authorized to and did report their income on the accrual basis (R. 73) for the calendar year (R. 15).

On May 28, 1942, Mr. Dally, doing business as Prefabricated Products Co., entered into a contract with the United States of America acting through the Federal Public Housing Authority (R. 28, 29, 30). This contract called for the manufacture and delivery of 1,000 prefabricated demountable housing units consisting of certain numbers of one, two and three-bedroom units at specified prices per unit.

Article 8 of the contract provided as follows (R. 30):

> "PAYMENTS.—The contractor shall be paid, upon the submission of properly certified invoices or vouchers semi-monthly, ninety per cent (90%) of the prices stipulated herein for articles delivered and accepted or services rendered, less deductions, if any, as herein provided. The remaining ten per cent (10%) of the prices stpulated herein shall not be paid until all of the construction and erection work of all the dwelling units has been finished and finally accepted by the contracting officer."

The first deliveries were made in October, 1942, and the contract was completed in 1943 (R. 26).

Following the deliveries, from time to time of com-

pleted units, and parts of others, eight "Periodical Estimates for Partial Payment" were prepared on Government forms (R. 42) by an employee of the Federal Housing Authority (R. 49). They were then certified to by Mr. Dally and by the Area Project Manager, a Government employee (R. 33, 26).

During the course of performance of the contract, Mr. Dally certified to certain periodical estimates, covering certain periods; these the Tax Court erroneously assumed were certified and submitted on the dates set forth in Petitioners Exhibit No. 10 (R. 64) as witness the change made to "Date Submitted" (R. 75) (*infra*, p. 20) in the Tax Court's Findings of Fact. An examination of Periodical Estimate No. 6, Petitioners' Exhibit No. 7 (R. 32, 33, 34) will demonstrate this oversight. It will be noted, that the period covered is December 16, 1942, to December 31, 1942 (R. 32), but that the certification signed by Mr. Dally is dated January 6, 1943. The certificates of the Area Project Manager were not made earlier than January 6, 1943, as shown by the exhibit. It was stipulated that this document is a true and correct copy of the original (R. 26). This income should have accrued in 1943; not in 1942 as contended by the Commissioner.

It is petitioners' contention that the amount of $122,875.50 (90% of $136,528.34) as shown in Periodical Estimate No. 6, Petitioners' Exhibit No. 7 (R. 32, 33, 34) dated January 6, 1943, should be allocated to 1943 income rather than to 1942 income.

In reference to the ten per cent retention set forth in Petitioners' Exhibit No. 10 (R. 64) the Tax Court held

with petitioners' contention that those amounts should be properly allocated to 1943 income.

It is obvious that although the Tax Court correctly ruled that the ten per cent retention deducted from 1942 vouchers should be allocated to 1943 income, it erroneously allocated the voucher in question, which was certified and submitted in 1943, to 1942 income.

On July 10, 1951, the respondent, Commissioner of Internal Revenue, mailed to petitioners, a notice of deficiency proposing assessment against petitioner, Charles F. Dally, in the sum of $71,947.50 and against petitioner, Sarafrancis Dally, in the sum of $71,936.11 for the year ended December 31, 1943. Petitioners made their returns to the Collector of Internal Revenue, Tacoma, Washington. On October 8, 1951, pursuant to 26 U.S.C.A. Section 272, and within the 90-day period prescribed by that section, petitioners filed with the Tax Court their petitions for redetermination of said deficiencies and for refunds (R. 3, 5, 7). These petitions were heard on October 23, 1952 (R. 35) and the Tax Court promulgated its findings of fact and opinion on August 7, 1953 (Appendix B, *infra*, p. 17) (R. 71-82 inclusive) being reported in 20 T.C. 894.

The decisions of the Tax Court were entered October 20, 1953, and served October 21, 1953 (R. 93, 94). They provided that there was a deficiency in income tax of $18,017.24 for Charles F. Dally and the sum of $18,017.24 for Sarafrancis Dally for the taxable year ended December 31, 1943. Petitioners filed their petitions for review to the United States Court of Appeals for the Ninth Circuit on January 18, 1954, with proof of service acknowledged the same date (R. 102, 103).

Jurisdiction of the court below rests upon 26 U.S.C.A. Sections 1141 and 1142.

REASONS FOR GRANTING WRIT

The decision of the court below in the instant case arising from the Ninth Circuit is directly in conflict with the decision of the Court of Appeals for the Tenth Circuit in *United States v. Harmon,* 205 F.2d 919. Both cases involve the question of accrual of income received from the performance of Government construction contracts after the submission of certificates for work performed which were required as a condition precedent for payment. It is the contention of the petitioner that the *Harmon* case, *supra,* correctly follows the principle expressed in *Spring City Foundry Co. v. Commissioner,* 292 U.S. 182, 184, in which it was stated:

> "Keeping accounts and making returns on the accrual basis, as distinguished from the cash basis, import that it is the right to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues,"

but that the opinion of the court below is in conflict with said case. The *Harmon* case, *supra,* is in harmony also with *Lucas v. North Texas Lumber Co.,* 281 U.S. 11, in which it was held that income accrues in the year when all contractual conditions for payment have been met, and not before. The decision in the instant case is not so in accord.

The *Harmon* case, *supra,* involved a construction contract with the Federal Housing Authority, which provided for the retention of 30% which would be paid

on final acceptance of the work by the Government in accordance with the terms of the contract. All construction work was completed in the latter part of 1943. On November 12, 1943, the taxpayer executed a certificate of completion showing a balance due him. Certain certifications were made by representatives of the Government in 1943 and some in 1944. On May 16, 1944, the taxpayer received the balance due him less certain minor deductions. The question arose as to whether or not the balance of the fixed fee should have been returned as income in 1943 as contended by the Government on appeal or whether the taxpayer was correct in returning it in his 1944 tax return.

The court in affirming the decision of the lower court and in upholding the position taken by the taxpayer said:

> " 'Harmon kept his books and made his tax returns on an accrual basis. It is a well-settled principle of law that where a taxpayer keeps his books and files his returns on the accrual basis, income is to be accounted for in the year in which it is realized, irrespective of when it is ultimately received. It is the right to receive and not the actual receipt of income that determines when income must be included in gross income for income tax purposes. When the right to receive income becomes fixed and absolute, the duty of one on the accrual basis to report it arises. * * *
>
> "PHILLIPS, Chief Judge (concurring).
>
> " 'It is my opinion that the acceptance of the work, not only by the project engineer, but by the regional construction adviser, the regional attorney, the regional labor relations adviser and the assistant director of Region VIII was a condition

precedent, and had to be obtained to render the obligation to pay the balance of the fixed fee fixed and absolute. See 9 Am. Jur., Building and Construction Contracts, Sec. 34, p. 24. For that reason, in addition to the reasons stated by Judge Huxman, it is my opinion that the judgment should be affirmed'."

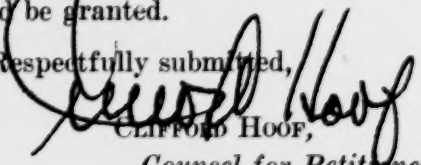
The decision of the court below is believed to be erroneous and the conflicting decision of the Court of Appeals for the Tenth Circuit reported in *United States v. Harmon*, 205 F.2d 919, is believed to be correct rather than the decision below which is in conflict with the principles established in *Spring City Foundry Company v. Commissioner, supra*, and *Lucas v. North Texas Lumber Co., supra.*

It is believed that the principle involved in this case is clearly of sufficient importance to be considered by this court. The problem of the allocation of accrued income to the proper tax year is one with which taxpayers are confronted with in numberless everyday commercial transactions. It is a problem that should be settled by this court.

CONCLUSION

For the foregoing reasons, this petition for a Writ of Certiorari should be granted.

Respectfully submitted,



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Of Counsel for Petitioners.

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

CHARLES F. DALLY and SARAFRANCIS DALLY, *Petitioners,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 14,249 Nov. 21, 1955

UPON PETITION TO REVIEW DECISIONS OF THE TAX COURT OF THE UNITED STATES

Before STEPHENS, HEALY and POPE, Circuit Judges.

POPE, Circuit Judge.

The petitioning taxpayers are husband and wife. The wife is involved only because the income here considered was community income under Washington law. By "petitioner," as used herein, we mean Charles F. Dally.

In May, 1942, petitioner entered into a contract with Federal Public Housing Authority for the manufacture and delivery of 1000 prefabricated housing units. Article 8 of the contract provided: "Payments—The contractor shall be paid, upon the submission of properly certified invoices or vouchers semi-monthly, ninety per cent (90%) of the prices stipulated herein for articles delivered and accepted or services rendered, less deductions, if any, as herein provided. The remaining ten per cent (10%) of the prices stipulated herein shall not be paid until all of the construction and erection work of all the dwelling units has been finished and finally accepted by the contracting officer." Deliveries under the contract began in October, 1942, and continued thereafter until about February 1, 1943. Payments aggregating $1,870,251.24 were made on invoices

or vouchers furnished from [1]* time to time, each setting forth the number of houses delivered in the period stated therein, generally semi-monthly. These were on forms supplied by the Authority, and headed "Periodical Estimate for Partial Payment." Eight such forms were presented. Payments were made from time to time in the amounts shown thereon. The first six (numbered 1 to 6) set forth the houses delivered in six periods named, the sixth being a period concluding December 31, 1942. Nos. 7 and 8 were for periods ending January 23, and January 31, 1943, respectively.

Petitioner reported his income on the accrual basis for the calendar year. His total profit from this contract was $832,202.33. He filed returns for the years 1942 and 1943 allocating the profit as follows: The total gross receipts from vouchers 1 to 6 inclusive were $1,621,666.06. Ten per cent of this was retained, as provided in Article 8, supra, the balance being $1,459,499.45. This latter figure was shown as gross receipts from the contract in 1942, and the returns for 1943 reflected gross receipts of $410,751.79, which included the 10 per cent retained amount from the houses delivered in 1942. Costs were allocated proportionately. In consequence some 80 per cent of the total profits were allocated to 1942. (The percentage figure is approximate. The original returns are not included in the record.)

After these original returns for the years 1942 and 1943 had been filed, the petitioner, following a study of the records of his shipments of housing units, came to the conclusion that the dates of actual delivery rather than the dates appearing on approved periodic esti-

*Page numbering appearing on printed decision.

mates should control the allocation of the total profit as between the years 1942-1943. Accordingly amended returns were filed showing the greater portion of the profit accruing in 1943 rather than in 1942.[1] The Commissioner determined a deficiency refusing to recognize the allocation of profits made in the amended returns and holding that the profit realized in 1942 should be reported on the basis of the certified periodic estimates, Nos. 1 to 6 inclusive, basing the same upon the total amount of gross receipts attributable to the houses listed herein without deduction of the 10 per cent previously mentioned. [2]

Upon petition to the Tax Court for a redetermination of the tax, that court in substance approved an allocation of the income substantially as calculated in petitioner's first returns for the two years mentioned. The Tax Court held, as petitioner contended, that his right to the 10 per cent retained under the contract did not ripen "until all of the construction and erection work of all the dwelling units has been finished and finally accepted by the contracting officer." In other respects it held that on December 31, 1942, the events had occurred which fixed the liability of the United States to pay and the petitioner to receive the total sum which was the aggregate of the amounts listed in the first six estimates less the 10 per cent retention.

Upon this petition to review this action of the Tax Court petitioner does not question the theory upon which the decision of the Court proceeded. No effort is

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[1]A second set of amended returns showing the same allocation was filed later for another purpose which is not material here and therefore we disregard them.

made to contend that the petitioner's right to the payments did not accrue until the dates of actual delivery of the complete units as suggested in his amended returns. The conclusion of the Court that it was the periodical estimates which determined the dates when the petitioner's right to be paid ripened and became absolute is acquiesced in by the petitioner as he presents his case here. What he now argues is a new point which does not appear to have been presented or suggested to the Tax Court, namely, that an examination of the periodical estimate No. 6, which was introduced in evidence before the Tax Court, and which purported to cover units delivered for the period December 16, 1942, to December 31, 1942, shows it was not certified by the petitioner as the contractor until January 6, 1943. Petitioner says that this circumstance, first brought to the attention of any court after the case reached us, means that petitioner's right to receive the $136,528.34 shown by periodical estimate No. 6 did not accrue to him in the tax year 1942 since this certification and the submission of the invoice properly certified was a condition precedent to the right to collect the money.

The respondent says that this new point, not presented to nor decided by the Tax Court cannot be urged here as ground for reversal of the Court below. An examination of the pleadings before that Court and of its findings and decision confirms the respondent's assertion that this new point relating to the date of certification of estimate No. 6 was not called to the attention [3] of the Tax Court but rather that the case was tried upon the assumption by all parties that the first six estimates were submitted on or before December 31, 1942.

In tax cases brought here upon appeal from a decision of a district court we have held that the appellant cannot fairly urge as ground for reversal a theory which it did not present while the case was before the trial court. United States v. Waechter, 9 cir., 195 F. 2d 963.

Petitioner says that what he here seeks is not the presentation of a new theory but merely to urge that the record shows that the Tax Court, whether inadvertently or not, erroneously failed to apply the law to the facts as shown by the record. We find it unnecessary to determine whether the rule of Waechter, supra, forecloses petitioner's present argument for we are of the opinion that it cannot be sustained upon the merits.

With respect to the houses listed in the periodic estimate No. 6, all of which had been delivered on or before December 31, 1942, petitioner's right to receive the agreed prices other than the 10 per cent retention had matured without further substantial contingency. It is true that before petitioner could get his money the sums represented by these houses so delivered would have to be filled in on the form, added up, computed and signed.

The facts here bring the case within the principle of Continental Tie & L. Co. v. United States, 286 U.S. 290, 295, which holds that income may not be deferred after the right matures, even although the ministerial act of computing the amount occurs in the subsequent year, and this although the administrative procedure to ascertain the amount to be paid is that of a public commission. Here the certificate of January 6, 1943 related back to and spoke as of December 31, 1942, when the right to

the money had matured by the delivery of the houses. This mere mechanical act of making out the necessary voucher did not operate to postpone the accrual of the sum which had been earned. Commissioner v. Dumari Textile Co., 2d cir., 142 F.2d 897, 899-900. Sums payable because earned are not rendered contingent and nonaccrued by the mere fact that some additional acts are necessary in order to make the collection, even if those acts must be performed later by third persons or by the govern[4]ment Automobile Ins. Co. v. Commissioner, 2d cir., 72 F. 2d 265, 267-268. Thus the court has held that a sum payable under a judgment against the United States is accruable in the year when the judgment becomes final notwithstanding Congress has yet to make the necessary appropriation to enable the judgment creditor to get his money. H. Liebes & Co. v. Commissioner, 9 cir., 90 F. 2d 932, 939.

It is therefore our opinion that the circumstances relating to the dating of the invoice or voucher on January 6, 1943 did not operate to prevent the accrual of 90 per cent of the amount of that voucher as of December 31, 1942.

The judgment is affirmed.

(Endorsed:) Opinion. Filed Nov. 21, 1955.
Paul P. O'Brien, Clerk. [5]

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

CHARLES F. DALLY and SARAFRANCIS DALLY, *Petitioners,*
vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent.*
No. 14249

JUDGMENT

Upon petition to review Decisions of the Tax Court of the United States.

This cause came on to be heard on the Transcript of the Record from the Tax Court of the United States, and was duly submitted:

On consideration whereof, It is now here ordered and adjudged by this Court, that the decision of the said Tax Court of the United States in this cause be, and hereby is affirmed.

(ENDORSED) Judgment
Filed and Entered: November 21, 1955
PAUL P. O'BRIEN, Clerk.

Excerpt from Proceedings of Thursday, December 22, 1955

Before: STEPHENS, HEALY & POPE, *Circuit Judges*

ORDER DENYING PETITION FOR REHEARING

On consideration thereof, and by direction of the Court, IT IS ORDERED that the petition of Petitioners, filed December 10, 1955, and within time allowed therefor by rule of Court for a rehearing of the above cause be, and hereby is denied.

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

CHARLES F. DALLY and SARAFRANCIS DALLY, *Petitioners,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 14249

CERTIFICATE OF CLERK, U.S. COURT OF APPEALS FOR THE NINTH CIRCUIT, TO RECORD CERTIFIED UNDER RULE 21 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITED STATES.

I, PAUL P. O'BRIEN, as Clerk of the United States Court of Appeals for the Ninth Circuit, do hereby certify the foregoing one hundred and fifteen (115) pages, numbered from and including 1 to and including 115, to be a full, true and correct copy of the entire record of the above-entitled case in the said Court of Appeals, made pursuant to request of counsel for the Petitioners, and certified under Rule 21 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

ATTEST my hand and the seal of the said the United States Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this thirteenth day of January, 1956.

PAUL P. O'BRIEN

(Seal) .....

Paul P. O'Brien, Clerk.

APPENDIX B

DECISION OF THE TAX COURT OF THE UNITED STATES

20 T.C. No. 126

THE TAX COURT OF THE UNITED STATES

CHARLES F. DALLY, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

SARAFRANCIS DALLY, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket Nos. 37118, 37119. Promulgated August 7, 1953.

TIME OF ACCRUAL OF INCOME—The petitioner, on the accrual basis, contracted with the United States Government in 1942 to manufacture and deliver housing units. Performance of the contract was completed in 1943. Payments under the contract were to be made on the basis of periodical estimates certified to by the petitioner and the Government, and were so made. The contract also provided that 10 per cent was to be retained until final acceptance by the Government contracting officer. Estimates submitted in 1942 showed the contract 86.7 per cent performed in that year. This was not contested by the Government. *Held,* the petitioner should have accrued in 1942, 86.7 per cent of the contract price less the 10 per cent the Government was entitled to retain.

GERALD D. HILE, ESQ., for the petitioners.

JOHN H. PIGG, ESQ., for the respondent. [1]*

[Court Seal]

*Numbers are page numbering of typed opinion.

The Commissioner determined the following deficiencies in income tax for the year 1943:

Charles F. Dally	$71,947.50
Sarafrancis Dally	71,936.11

The only question for decision is the proper amounts to be accrued in 1942 and 1943 under a contract for prefabricated housing units between the petitioner Charles F. Dally, d.b.a. Prefabricated Products Co., and the United States. The year 1942 is involved because of the foregiveness features of the Current Tax Payment Act of 1943.

FINDINGS OF FACT

The stipulated facts are so found and the stipulation incorporated herein by reference.

At all times involved herein the petitioners were husband and wife, residents of the State of Washington, and all income involved was community income. Their returns were filed for the years 1942 and 1943 with the collector of internal revenue for the district of Washington. The petitioners were authorized to and did report their income on the accrual basis. Charles F. Dally will hereafter be referred to as the petitioner.

During 1942 and 1943 the petitioner was engaged in the construction business. On May 28, 1942, he, doing business as Prefabricated Products Co., entered into a contract with the United States of America acting through National Housing Agency. This contract called for the manufacture and delivery of 1,000 prefabricated demountable housing units consisting [2] of certain numbers of one, two, and three-bedroom units at specified prices per unit. The first deliveries were made in October, 1942, and the contract was completed in February or March, 1943. Because of the shortage of certain materials, units were not necessarily complete at the time of delivery.

Article 8 of the contract provided as follows:

> Payments.—The contractor shall be paid, upon the submission of properly certified invoices or vouchers semi-monthly, ninety per cent (90%) of the prices stipulated herein for articles delivered and accepted or services rendered, less deductions, if any, as herein provided. The remaining ten per cent (10%) of the prices stipulated herein shall not be paid until all of the construction and erection work of all the dwelling units has been finished and finally accepted by the contracting officer.

Following the deliveries from time to time of completed units and parts of others eight "Periodical Estimates for Partial Payment" were prepared on Government forms. These estimates were certified to by the petitioner and on behalf of the United States by the area project manager. They were based on estimates of completed units and took into consideration certain change orders which did not affect the number of units to be manufactured. No attempt was made by either party to check the exact number of "complete" units actually delivered before certifying the estimates.

The periodical estimates certified to in 1942 showed 862 units delivered in 1942 and indicated that 86.7 per cent of the contract had been performed. The estimate for 1943 showed 138 units delivered in that year.

Payments under the contract were made in 1942 and 1943 based on the figures shown in the "Periodical Estimate for Partial Payment." The following tabulation shows that payments made to the petitioner by the [3] Government on account of performance of the contract in question, on the basis of the eight progress reports, as above stated:

Periodical Estimate No.	*Date Submitted*	*Number of Houses*	*Amount of Partial Pymt.*
1	Oct. 15, 1942	20	$ 36,499.60
2	Oct. 31, 1942	140	254,568.78
3	Nov. 30, 1942	200	390,997.22
4	Dec. 14, 1942	210	399,265.10
5	Dec. 29, 1942	220	403,807.02
6	Dec. 31, 1942	72	136,528.34
Total estimates for partial payments in 1942			$1,621,666.06
7	Jan. 23, 1943	100	176,662.82
8	Jan. 31, 1943	38	71,922.36
Total contract price			$1,870,251.24

In accordance with the above-quoted provision of the contract, ten per cent of the amount of each estimate for partial payment was retained by the Government pending completion of the contract in a manner acceptable to the contracting officer. The amount retained with respect to the total estimates for partial payments in 1942 of $1,621,666.06 amounted to $162,166.61. Payment on account of the last progress report (No. 8) was made to the petitioner in February or March, 1943, and final payment of the ten per cent retained was made to him in June, 1943. The dates of actual payments of the remaining amounts shown in the above tabulation are not disclosed by the record.

The petitioners in making their original 1942 and 1943 income tax returns reported their accrued income on the basis of the partial payments received by them under such estimates. Accordingly, their original 1942 returns showed gross receipts of $1,459,499.45 from the contract in 1942, [4] based on the estimated 862 completed units certified to have been

delivered in 1942, less 10 per cent, and their 1943 original returns reflected gross receipts of $410,751.79, based on the estimated 138 completed units certified to have been delivered in 1943, which also included the 10 per cent retained amount of the whole contract which was paid in 1943; costs were likewise so proportionately allocated between such years.

The petitioner derived a profit of $832,202.33 from the contract.

On March 20, 1947, the petitioner and his wife filed separate amended returns for the years 1942 and 1943, in which the profit of $832,202.33, so derived from the Government contract here in controversy, was allocated, respectively, in the amounts of $380,396.47 and $451,805.86. In these separate amended returns, the last two stated amounts were divided equally between the petitioner and his wife, i.e., $190,198.23 was allocated to each of them for the year 1942, and $225,902.93 was allocated to each of them for the year 1943. These amended returns of the petitioner disclosed income tax and/or income and victory tax liabilities for the years 1942 and 1943, in the respective amounts of $144,742.65 and $215,245.02, with corresponding tax liabilities being shown on the corresponding amended separate returns filed by his wife.

The revised figures, including the reductions in tax liabilities, and the filing of the amended returns were the result of certain estimates and computations made by the petitioner's brother who was in the employ of the petitioner, in a supervisory capacity, during the years 1942 and 1943, and [5] the petitioner's accountant. The petitioner's brother, some time subsequent to the filing of the petitioner's original returns for the years 1942 and 1943, made a check or "analysis" of the bills of lading covering the shipments from Seattle to Bremerton, by ferry, of the various prefabricated parts

of the several housing units, for the purpose of ascertaining the number of completed units actually delivered on the building sites, at the latter place, during each of those years, which were 1942 and 1943. Based upon the figures so arrived at the accountant prepared a statement, in which he arrived at the percentage figures of 58.96 and 41.04, as representing the number of completed housing units actually delivered during those respective years. The amended returns, referred to above, were prepared by the accountant and the revised figures, including the reduction in tax liabilities, as shown thereon were based on the percentage figures so computed and arrived at by him.

On June 13, 1947, the petitioner and his wife filed a second set of amended returns for the years 1942 and 1943, wherein the profit of $832,202.33 was allocated in the same manner and amounts as in their first set of amended returns, but in which their respective separate community net incomes and tax liabilities were shown in reduced amounts, because of another income adjustment, relating to an alleged increased net operating loss carry-back, which is not now in controversy.

In his determination of the deficiencies involved in these proceedings, the Commissioner further determined that of the total profit of $832,202.33, [6] so derived by the petitioners from the contract the sum of $714,846.52 constitutes community income taxable to them for the year 1942, the balance of $117,355.81 being includible in their community income for the year 1943. In support of such determinations, the notices of deficiencies were accompanied by the following explanatory statements:

> It is held that the profit realized on the partial completion of your contract No. WAh (D-WASH-45111)-1, with the Federal Public Housing Authority, should be reported in the year 1942 for

income tax purposes to the extent of $714,846.52, on the basis of the certified Periodical Estimate for Partial Payment furnished by you to the Federal Public Housing Authority covering work completed to December 31, 1942, under the contract. Your community one-half of this profit was $357,423.26, $167,225.03 in excess of the amount reported in your second amended return.

* * * * * * * * *

It is held that the profit realized on the completion of your contract No. WAh (D-WASH-45111)-1, with the Federal Public Housing Authority, should be reported for income tax purposes to the extent of $117,355.81 in the year 1943 by you and your wife, Sarafrancis Dally, that amount being the portion of the contract profit not reportable in the year 1942. Your community one-half of this profit was $58,677.91 instead of $225,902.93, the amount reported in your amended return.

The amount of $714,846.52, representing the portion of the total profit in controversy which the Commissioner has so treated as community income of the petitioners for the taxable year 1942, represents approximately 86.7 of such total profit.

Of the total contract price of $1,870,251.24, the aggregate of the partial payments which were either paid or were payable to the petitioner on account of work performed under the contract during 1942, on the basis of the progress reports was $1,621,666.06, less the 10 per cent retainage. [7]

There was no substantial contingency as to the right of the petitioner to receive on December 31, 1942, the full amount of any then unpaid portion of the aforesaid amount of $1,621,666.06, except the 10 per cent retainage.

On, or as of December 31, 1942, the events had occurred which fixed the liability of the United States of America to pay to the petitioner 86.7 per cent of the total contract price for $1,870,251.24, or $1,621,666.06, less the 10 per cent retainage.

OPINION

TIETJENS, *Judge*: There is no controversy between the parties as to the principles which should govern the questions here in issue. Both cite and rely on *Spring City Foundry Co. v. Commissioner*, 292 U.S. 182. It is over the application of those principles to the facts of this case that differences arise.

The petitioner, in effect, contends that the contract called for "completed" units, and that the estimates for partial payments were, after all, only estimates and did not accurately reflect the amounts to the payment of which he was entitled of right. Consequently, the estimates being in error as a matter of hindsight checking, he says he was entitled to accrue income on the basis of actually delivered completed units only and was not bound to accrue the amounts called for by the estimates which he was in fact paid.

We do not agree with the petitioner in his contention. The contract provided that payments should be made upon the submission of properly [8] certified vouchers of 90 per cent of the stipulated prices for articles delivered or services rendered. In this case, as we see it, these certified invoices or vouchers were the "Periodical Estimates for Partial Payment" referred to in our findings of fact. These estimates were certified to both by the petitioner and the Government. It is obvious from the facts that the certified figures contained in the estimates were to be the basis for determining the amounts which the petitioner was entitled to be paid and which he was in fact paid. No controversy

existed between the petitioner and the Government over the petitioner's right to the payments in question, and the only reason the question is now raised is that the petitioner himself raises it in the hope of gaining a tax advantage. While the contract was in the course of performance neither party contemplated any course other than that payments were to be figured and paid on the basis of the estimates. As we see it, the petitioner's right to be paid ripened and became absolute upon the submission of the certified periodical estimates. That right did not depend upon a recheck of the figures shown on the estimates; and neither was the amount to be paid governed only by completed units actually delivered. The project engineer for the Government was called as a witness by the petitioner. He testified that there naturally were deviations between the estimates and actual completed units delivered, and, in response to the Court's question as to whether payments were made according to the testimates or actual count, responded, "the payment was made on the basis of the periodical estimate." [9] On the record before us we have found that on December 31, 1942, the events had occurred which fixed the liability of the United States to pay and the petitioner to receive 86.7 per cent of the total contract price less the 10 per cent retainage. Accordingly, that amount should have been accrued in 1942. This disposes of the main issue.

One other question remains to be answered. The Commissioner determined that the full 86.7 per cent should have been accrued in 1942. The petitioner argues that even if we decide the main issue against him, at least it would not be proper to include the 10 per cent retainage in his accrual for 1942. The Commissioner contends this issue is not before us because not specifically raised by the pleadings. We think, however, that a fair construction of the pleadings places the treatment by the

Commissioner of the 10 per cent retained in issue. Under the contract, as we read it, the petitioner's right to the 10 per cent did not and could not ripen "until all of the construction and erection work of all the dwelling units has been finished and finally accepted by the contracting officer." That did not happen until 1943 and the petitioner, accordingly, did not have to accrue 10 per cent in 1942 of the periodical estimates submitted in that year.

We hold, therefore, that the petitioner should have accrued in 1942, $1,621,666.06 less 10 per cent.

Decision will be entered under Rule 50. [10]

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	3
Argument	6
Conclusion	10

CITATIONS

Cases:

American National Co. v. *United States*, 274 U. S. 99 — 7, 8

Brown v. *Helvering*, 291 U. S. 193 — 7

Continental Tie & L. Co. v. *United States*, 286 U. S. 290 — 7

General Utilities Co. v. *Helvering*, 296 U. S. 200 — 9

Helvering v. *Salvage*, 297 U. S. 106 — 9

Helvering v. *Wood*, 309 U. S. 344 — 9

Hormel v. *Helvering*, 312 U. S. 552 — 9

Lucas v. *North Texas Co.*, 281 U. S. 11 — 9

Oscanyan v. *Arms Co.*, 103 U. S. 261 — 9

Spring City Co. v. *Commissioner*, 292 U. S. 182 — 7

Sweeney v. *United States*, 109 U. S. 618 — 8

United States v. *Anderson*, 269 U. S. 422 — 7

United States v. *Harmon*, 205 F. 2d 919 — 8

Statute:

Internal Revenue Code of 1939:

Sec. 41 (26 U. S. C. 1952 ed., Sec. 41) — 2

Sec. 42 (a) (26 U. S. C. 1952 ed., Sec. 42 (a)) — 3